Palliser Resources Inc. Annual Report 1981

Corporate Information

SUBSIDIARY (WHOLLY OWNED)
Palliser Resources (U.S.), Inc.

HEAD OFFICE
1420 - 625 Howe Street,
Vancouver, B.C. V6C 2T6
Telephone: (604) 669-0225

SUBSIDIARY OFFICE
308 Northeast 27th, Oklahoma City, Oklahoma

DIRECTORS & OFFICERS
John A. MacPherson, Vancouver
President & Director
Murdock A. Smith, Vancouver
Secretary-Treasurer, Director
Carlo Civelli, Zurich, Director
Glenn McRae, Vancouver, Director
Michael Wyler, Geneva, Director

SOLICITORS
Sobolewski & Anfield, Vancouver, B.C.
(U.S.) Day & Fredrickson, Oklahoma City, Oklahoma

AUDITORS
Carlyle Shepherd & Co., Vancouver, B.C.
(U.S.) Coopers & Lybrand, Oklahoma City, Oklahoma

TRANSFER AGENTS
Yorkshire Trust Company, Vancouver, B.C.

BANKERS
Toronto-Dominion Bank, Hastings & Seymour Sts., Vancouver, B.C.
(U.S.) Penn Square Bank, Penn Square Center, Oklahoma City, Oklahoma

CONSULTING ENGINEER
Esau, Finn & Associates Ltd., Vancouver, B.C.

SHARES AUTHORIZED
10,000,000 shares

SHARES ISSUED
4,855,282 shares

LISTED
Vancouver Stock Exchange (PRI)
London Stock Exchange (Foreign Exchange Exemption)

FISCAL AGENTS AND BROKERS TO THE COMPANY
de Zoete & Bevan
25 Finsbury Circus, London

Highlights

A message from the President

Profitable long-term involvement in oil and gas exploration depends in large measure on minimizing the risk factor. That our company has managed to do precisely that is the root cause of an outstanding growth record.

From our inception in 1978, Palliser Resources has adhered to a carefully controlled investment policy . . . with a full 70% of drilling investment directed into *medium risk* plays. A further 20% is allocated to higher risk ventures, and no more than 10% to true wildcat projects.

We have further minimized risk by exercising great care in our choice of operators, selecting proven operator with long experience in their respective drilling areas . . . operators with access to the essential drilling rigs and acreage. Another important point: on every project to date, our operators have held a substantial financial interest in the wells being drilled. They are thus personally committed to the rapid, cost-efficient completion of every well.

A sound investment policy coupled with careful selection of operating partners: it's an approach that has removed much of the risk from oil and gas exploration, as our record to date clearly indicates.

A remarkable success ratio

The past year has seen completion of our first 42-well program, with drilling concentrated primarily in the Anadarko Basin and Sooner Trend areas of Oklahoma. Of these 42 wells, 27 have proven successful and 22 have commenced production. Output per well varies considerably, but the overall average is over 90 barrels of oil daily, including gas equivalent. (6,000 cubic feet of gas equals one barrel of oil) Revenue from these wells is expected to average more than $350,000 U.S. monthly for the ensuing 12 months. Production figures covering the second half of the 1981-82 fiscal year will be greater by far than the first half as we expect to double the number of wells on line.

Among the more significant wells drilled during the last fiscal season was the Walker well in Dewey County, Oklahoma. This well was tested in excess of 10,000,000 cu. ft. open flow per day, and is expected to be on line by August, 1981. This outstanding prospect encountered 12.5% porosity and 55 feet net pay in the Hunton formation. (The Company is already in receipt of a contract for the gas at $7.10 per mcf.) We are presently drilling two offsets to this well, to pick up the highly promising Red Fork upper zones.

On another major producer — the Gould well — the company anticipates drilling a minimum of five further offsets. The Gould well came on production at 576 barrels plus 500,000 cu. ft. of gas per day, and is expected to stabilize above 350 barrels of oil per day plus 500,000 cu. ft. of gas. The Company anticipates revenues of approximately $700,000 in the coming year from this single well location. Palliser holds a 25% working interest in the Gould field — as indicated later in this report, this is fairly typical of the degree of participation by our company in its drilling ventures.

It should be noted that our single wildcat play of the past year has proven a failure, at least to this point. This is a major Brazilian operation, with Palliser holding a 1% working interest in a vast drilling tract offshore from the Amazon Delta. Initial activity proved unsuccessful when the rig experienced a twist-off, and no decision has been made on drilling a second well.

Palliser's investment on this wildcat amounted to $300,000, or less than 2% of our total capital budget of $17 million. We feel the investment was merited on the basis of the potential rewards, and will continue to pursue selected wildcats within carefully controlled financial limits.

The promise of the Tuscaloosa

Potentially the most rewarding new venture for Palliser in the coming year lies in the Tuscaloosa Trend area of Louisiana. As detailed later in this report, our company has acquired substantial acreage within this vast

territory: acreage which offers exciting drilling possibilities in the months ahead.

The decontrol of prices on natural gas found below 15,000 feet has caused virtually every major exploration company to focus on the Tuscaloosa. To take advantage of its holdings in this dynamic area, Palliser will allocate 50% of its budget during the coming year to activities in the Tuscaloosa. There will be keen competition and a certain degree of risk . . . but Palliser is well situated to participate in what is regarded as the new boom area in North America for natural gas production.

Investment in the Tuscaloosa will not diminish our continued involvement in the proven producing regions of Oklahoma. In fact, we are already planning to extend operations here to exploit the new decontrolled pricing which applies to deeply situated natural gas. In concert with proven operator partners, Palliser will continue to go "where the action is" . . . always spreading the risk by carefully diversifying our drilling investments.

Ample financing for future growth

In its combined operations, Palliser Resources has shown impressive growth in a relatively short period of time. Paid-in capital has increased from $69,000 in February, 1980 to over $16 million as of May, 1981. Signs of our growth and maturity were evident in two recent events on the Vancouver Stock Exchange.

On May 15th, Palliser successfully completed one of the largest financings ever handled by the Vancouver Stock Exchange. The offering provided over $10 million — more than sufficient to meet the needs of our current drilling program for the coming fiscal year. A few days later, on May 18th, Palliser Resources was moved from the Development section to the Resource board of the Exchange. In addition, our company has recently made application for trading on the NASDAQ system in New York, and expects confirmation of this listing shortly.

A closing note pertains to recent media discussion of a potential "glut" in U.S. oil and gas production. It should be remembered that

only a few years ago, gas was a mere 17¢ per thousand cubic feet, and that prices today are as high as $8.70. While there has been inflation in drilling costs, it by no means matches the rise in selling prices . . . prices which continue to rise because of sustained demand. The company will persist with its program to seek out oil and gas in areas where the existence of gathering systems and refinery capacity guarantees a ready market for new discoveries.

Our confidence in the future growth of the industry is shown by our determination to build, in cooperation with our operators, an ever larger land bank in proven petroleum-producing regions. We will do so on the basis of leases extending between three and five years.

Looking beyond the next fiscal year, we anticipate the opportunity to drill in the Williston and Powder River basins of the United States. We further plan to explore prospects in Texas, both in the eastern portion of the state and in the Gulf area.

The past year has been one of rapid but carefully planned growth. We see many such years ahead.

John H MacPherson President.

Oklahoma Holdings

Of the 39 successful wells in which Palliser is currently involved, the vast majority are located in the Anadarko Basin and Sooner Trend areas of Oklahoma. Both regions are historically prolific producers of oil and gas, and have been focal points of development in recent years.

Before entering these areas, Palliser management undertook an intensive study of the larger number of operators headquartered in Oklahoma. The result of this search was the selection of two operators . . . each with a proven record of success in the areas mentioned, and each with a substantial lease inventory of petroleum-bearing property.

By investing in drilling projects on this operator-held property, Palliser became a working partner with organizations which were already profitably operating in the territory. At this point, our company has an interest in projects which involve a large total acreage position in the Anadarko Basin and Sooner Trend areas. In addition, our relationship with our operating partners is such that we have been offered the option of participating in all future ventures undertaken by these companies.

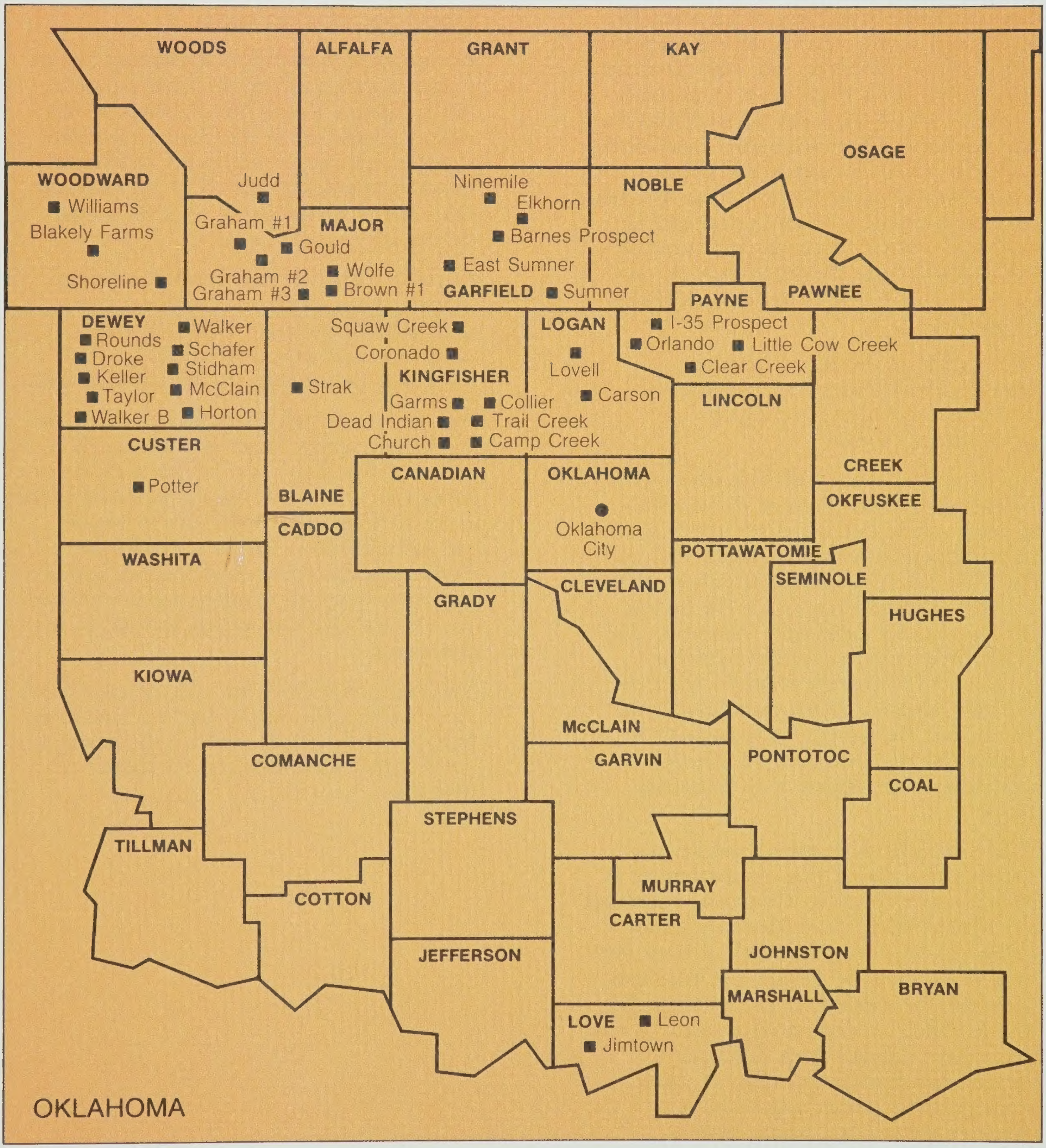
Many more wells

The excellent success ratio enjoyed thus far in Oklahoma provides the basis for planning future expansion in this state. Palliser has allocated approximately $5 million for the drilling of a further 26 wells in the Anadarko and Sooner Trend by the end of December, 1981. The company is committed to drill 14 of these wells, and anticipates signing contracts on the remaining 12 in the near future.

As previously mentioned, Palliser will also pursue deep drilling projects in Oklahoma, to exploit the new decontrolled natural gas prices. We will be involved in the drilling of wells from 14,000 to 22,000 feet in depth, with an operator holding over 5,000 net acres in the deep Anadarko Basin.

The extent of these planned ventures reflects our confidence both in our operating partners and in the continued productivity of the Anadarko and Sooner Trend areas. It is a confidence built on a solid record of achievement.

The Gould Well in Major County.


WOODS
ALFALFA
GRANT
KAY
OSAGE
WOODWARD
Williams
Blakely Farms
Shoreline
Judd
Graham #1
Gould
Graham #2
Graham #3
MAJOR
Wolfe
Brown #1
Ninemile
Elkhorn
Barnes Prospect
East Sumner
GARFIELD
Sumner
NOBLE
PAYNE
PAWNEE
DEWEY
Walker
Rounds
Schafer
Droke
Stidham
Keller
McClain
Taylor
Horton
Walker B
Squaw Creek
Coronado
KINGFISHER
Strak
Garms
Collier
Dead Indian
Trail Creek
Church
Camp Creek
LOGAN
Lovell
Carson
I-35 Prospect
Orlando
Little Cow Creek
Clear Creek
LINCOLN
CUSTER
Potter
BLAINE
CADDO
CANADIAN
OKLAHOMA
Oklahoma City
CREEK
OKFUSKEE
WASHITA
POTTAWATOMIE
SEMINOLE
CLEVELAND
GRADY
HUGHES
KIOWA
McCLAIN
COMANCHE
GARVIN
PONTOTOC
COAL
STEPHENS
TILLMAN
COTTON
MURRAY
CARTER
JEFFERSON
JOHNSTON
MARSHALL
BRYAN
LOVE
Leon
Jimtown
OKLAHOMA

The Tuscaloosa Trend Area

The Tuscaloosa Trend area of Louisiana has long been known as the site of vast quantities of natural gas. However, only with the recent U.S. federal government move to decontrol prices on natural gas found below 15,000 feet has deep drilling been considered economically viable. With the new regulations in place, exploration companies flocked to the area and land prices soared — from $15 per acre in 1970 to as high as $9,000 per acre currently for wildcat acreage. Palliser to date has paid an average of $1,333 per net acre, including seismic data.

In the midst of this frantic landrush — through good planning and good fortune — Palliser found itself in a highly advantageous position.

Our company's care in selecting operators in Oklahoma provided access to the essential acreage, drilling rigs and crews to plan a major drilling program in the Tuscaloosa. Both of our Oklahoma operators are associated with Longhorn Oil and Gas, one of the leading U.S. oil and gas exploration companies. The Longhorn connection enabled Palliser to acquire a 12.5% interest in 28,000 net acres and approximately 45,000 gross acres in the Tuscaloosa. The acreage, comprised of 122 separate parcels throughout the Trend, represents an investment of $3 million by Palliser.

With Longhorn as a working partner, our company was able to plan commencement of its first two wells in the Tuscaloosa. Scheduled for August 15th in Saint Tammany Parish, Louisiana, these are seen as two of three test wells to be drilled by Palliser and Longhorn in the next six months. In the following 12 months, Palliser expects to be involved in nine wells, either through direct drilling or by farmout participation with other operators. Farming out of acreage is a means of spreading the risk in a highly capital-intensive enterprise.

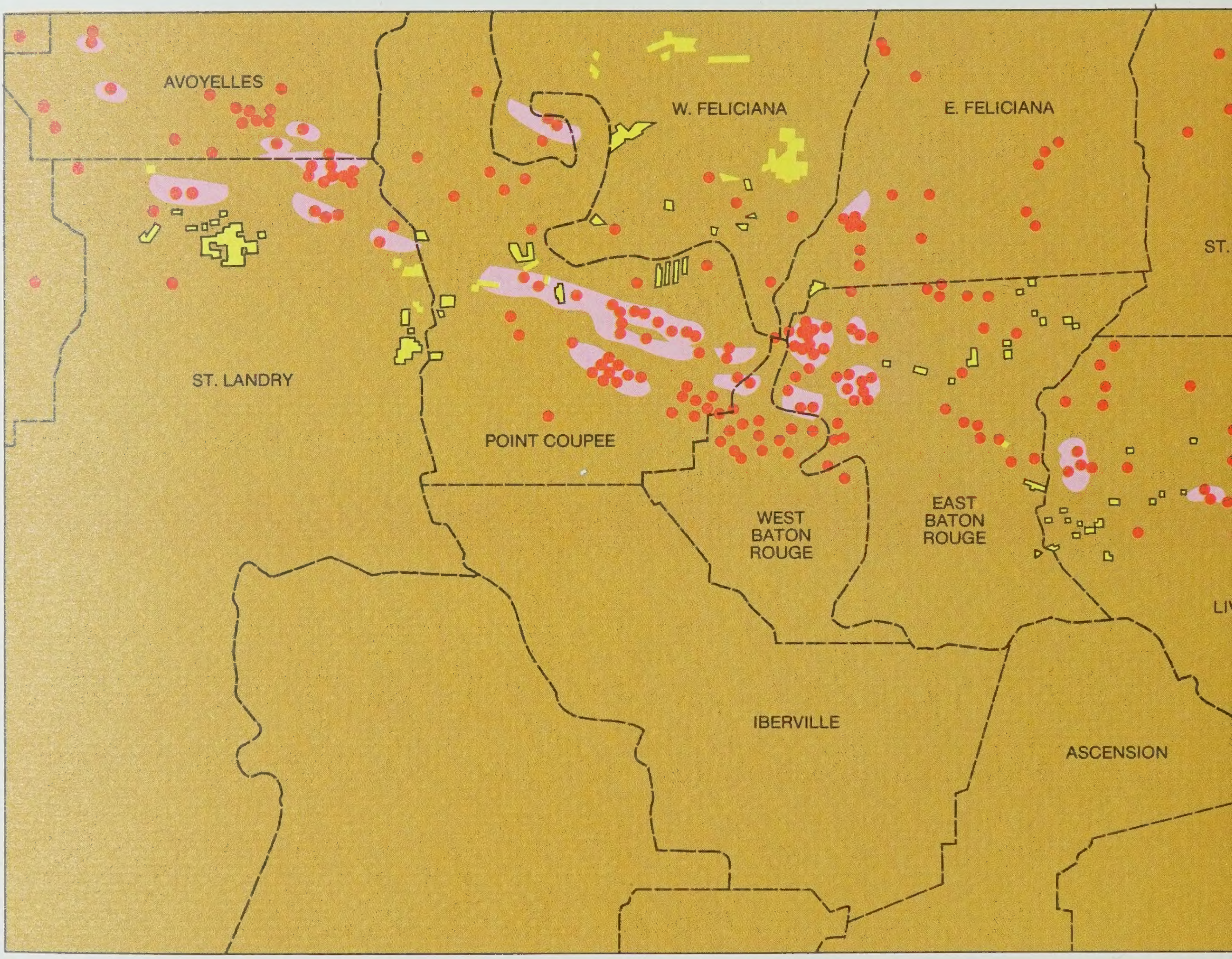
Great potential rewards

As mentioned earlier, 50% of Palliser's budget for the coming year will be directed toward the Tuscaloosa Trend. The emphasis on this region is explained by the effect of decontrol, which is expected to yield prices of $51 per barrel for condensate and $8.70 per thousand cubic feet of natural gas — over three times the current regulated price.

Combined with the soaring prices is ease of access to major markets . . . through intra-state pipelines serving a large industrial complex in and around Baton Rouge, Louisiana, and through interstate lines as well.

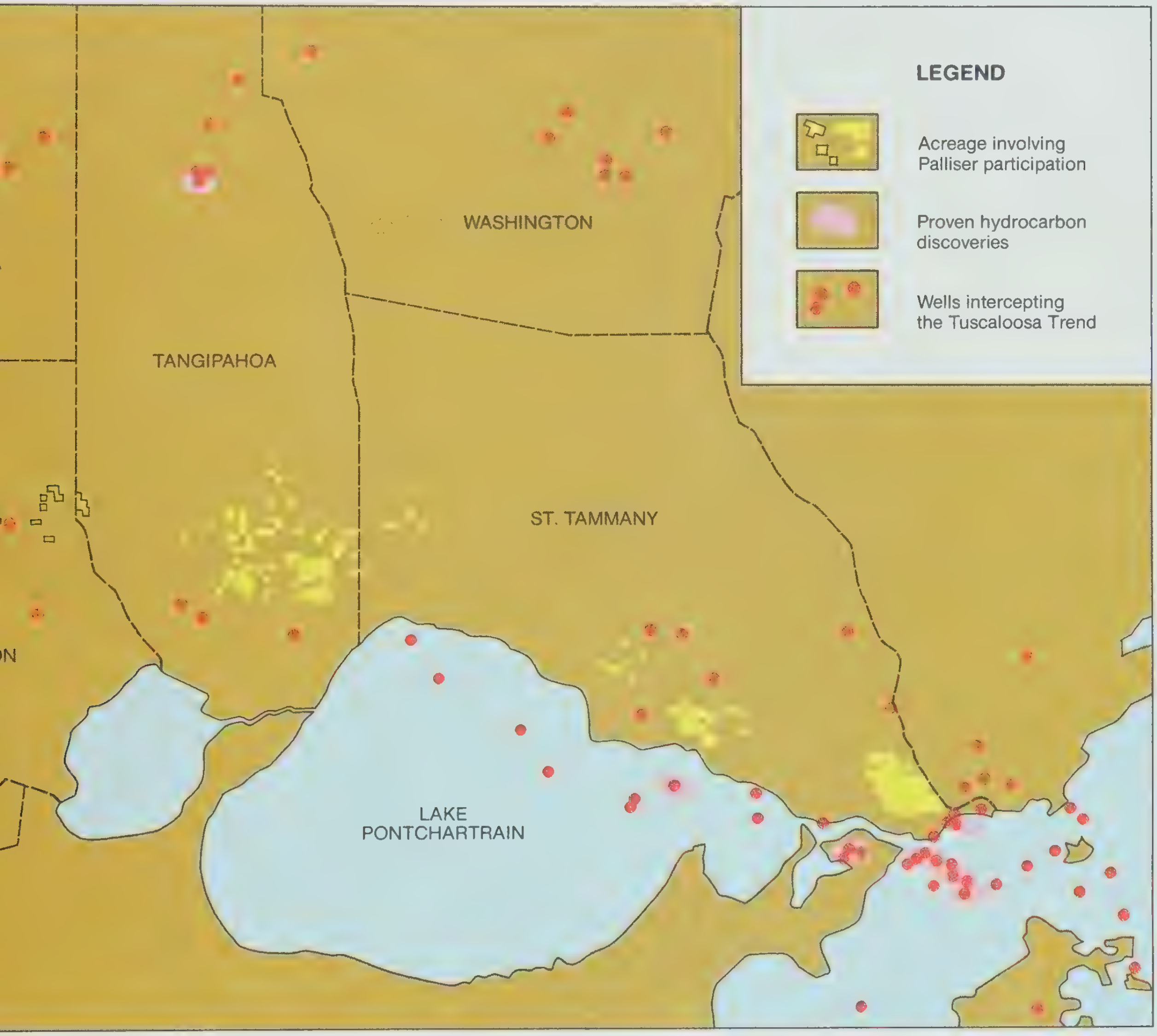
Anticipated per well production in the region is a further spur to rapid development. It is estimated that the *average* reserve for a well producing on 640 acre spacing would be in the order of 50-60 billion cubic feet of natural gas and one million barrels of condensate. Considering the prices quoted earlier, it is not surprising that such major companies as Shell, Amoco, and Gulf are actively involved in the Tuscaloosa.

We look forward with keen anticipation to the August 15th spud date of our first Tuscaloosa test well. It could well mark the beginning of a new phase of development for Palliser Resources.



Major partners in the Tuscaloosa Trend are

- Aminoil U.S.A. Inc. (a wholly-owned subsidiary of R.J. Reynolds Industries)
- Delta Drilling
- Longhorn Oil & Gas
- Mitsubishi
- NICOR
- **Palliser Resources Inc.**


LEGEND
Acreage involving Palliser participation
Proven hydrocarbon discoveries
Wells intercepting the Tuscaloosa Trend
WASHINGTON
TANGIPAHOA
ST. TAMMANY
LAKE PONTCHARTRAIN
ON

Palliser Resources Inc. and Subsidiary's Oil and Gas Interests and Commitments June 30, 1981

Well or Prospect	County	Working Interest %	Status or Production
OKLAHOMA			
Barnes Prospect	Garfield	43.75	OP
Blakely Farms	Woodward	25.00	WOC
Brown #1	Major	10.11028	PTD
Camp Creek	Kingfisher	12.50	OP
Carson	Logan	25.00	OP
Clear Creek	Payne	18.50	PA
Church	Kingfisher	25.00	OP
Collier	Kingfisher	15.625	C
Coronado	Kingfisher	18.75	OP
Dead Indian	Kingfisher	18.75	OP
Droke	Dewey	12.50	C
East Sumner	Garfield	25.00	C
Elkhorn	Garfield	18.75	PA
Garms	Kingfisher	18.75	OP
Gould	Major	25.00	OP
Graham #1	Major	6.187725	OP
Graham #2	Major	6.187725	OP
Graham #3	Major	6.187725	PTD
Horton	Dewey	25.00	WOC
I-35 Prospect	Payne	43.75	OP
Jimtown	Love	12.50	WOC
Judd	Woods	25.00	OP
Keller	Dewey	25.00	OP
Leon	Love	12.50	WOC
Little Cow Creek	Payne	18.75	OP
Lovell	Logan	25.00	OP
McClain	Dewey	25.00	WOC
Ninemile	Garfield	18.75	PA
Orlando	Payne	25.00	OP
Potter	Custer	25.00	WOP
Rounds	Dewey	15.79	PTD
Schafer	Dewey	25.00	OP
Shoreline	Woodward	15.00	OP
Squaw Creek	Kingfisher	18.75	OP
Stidham	Dewey	12.50	WOC
Strak	Blaine	25.00	D
Sumner	Garfield	25.00	WOP
Taylor	Dewey	25.00	PTD
Trail Creek	Kingfisher	18.75	OP
Walker	Dewey	6.25	C
Walker B	Dewey	4.16667	PTD
Williams	Woodward	25.00	PTD
Wolfe	Major	8.334	WOC
OHIO			
Romick #3	Washington	17.00	OP
Romick #4	Washington	17.00	OP
Webb #1	Washington	40.00	WOC
Webb #2	Washington	40.00	WOC
TEXAS	**Acreage**		
Hopper-Saunders Prospect	1,800	10.00	R
LOUISIANA			
Tuscaloosa	28,000 Net	12.50	PTD
BRAZIL	381,000	1.00	PA

OP — On production; WOC — Waiting on completion; PTD — Preparing to drill; PA — Plugged and abandoned; D — Drilling; R — Reviewing; C — Completing.

Consolidated Statement of Exploration, Development and Administration Costs

For the year ended May 31, 1980
(with comparative figures for eleven months ended May 31, 1981)

	Total	year ended May 31 1981	11 months ended May 31 1980
EXPLORATION AND DEVELOPMENT			
Assay and testing	34	—	$ 34
Contract work	1,500	—	1,500
Engineering	34,877	32,727	2,150
Travel, leases	689	—	689
	$ 37,100	$ 32,727	$ 4,373
ADMINISTRATION			
Audit and legal	$ 99,672	$ 88,410	$ 11,262
Advertising and shareholders' information	24,925	24,625	300
Bank charges and interest	3,121	3,041	80
Commission	5,000	—	5,000
Depreciation	3,244	3,204	40
Donation	2,700	2,700	—
Office	22,606	19,999	2,607
Rent	17,551	14,961	2,590
Salaries and benefits	6,602	6,602	—
Stock exchange fees and dues	18,426	16,076	2,350
Taxes and licence	2,140	2,140	—
Telephone	12,917	11,076	1,841
Travel, automotive and parking	69,117	62,462	6,655
Transfer fees	17,539	14,504	3,035
	305,560	269,800	35,760
Deduct: interest and miscellaneous income	125,743	124,342	1,401
TOTAL	$179,817	$145,458	$ 34,359

Consolidated Statement of Changes in Financial Position

For the year ended May 31, 1981
(with comparative figures for eleven months ended May 31, 1980)

	year ended May 31 1981	11 months ended May 31 1980
SOURCE OF WORKING CAPITAL		
Issue of shares	$15,410,250	$ 140,750
Proceeds of sale of ½ interest in oil and gas lease	—	23,149
	15,410,250	163,899
APPLICATION OF WORKING CAPITAL		
Deferred costs		
Exploration and development	32,727	4,373
Administration, excluding depreciation	142,254	34,319
	174,981	38,692
Purchase of investment in oil and gas leases	12,731,694	105,653
Purchase of investment in gas gathering system	91,217	—
Purchase of furniture and leasehold improvements	41,602	396
Incorporation costs	674	632
	13,040,168	145,373
INCREASE IN WORKING CAPITAL	2,370,082	18,526
OPENING WORKING CAPITAL	18,526	—
CLOSING WORKING CAPITAL	$ 2,388,608	$ 18,526

Consolidated Balance Sheet

May 31, 1981
(with comparative figures for 1980)

ASSETS

	1981	1980
CURRENT		
Cash	$ 42,741	$ 25,904
Term deposits	475,000	—
Accounts receivable	5,816,701	—
Prepaid expenses and deposits	282,472	—
	6,616,914	25,904
INVESTMENTS at cost		
Oil and gas leases (note 2)	12,814,198	82,504
Gas gathering system (note 3)	91,217	—
	12,905,415	82,504
FIXED, at cost (note 1)		
Furniture and office equipment	24,655	396
Leasehold improvements	17,343	—
	41,998	396
Accumulated depreciation	3,244	40
	38,754	356
DEFERRED COSTS (note 1)		
Exploration and development	37,100	4,373
Administration	179,817	34,359
	216,917	38,732
INCORPORATION COSTS	1,306	632
	$19,779,306	$ 148,128

APPROVED BY THE DIRECTORS

John A. MacPherson Director

Murdock A. Smith Director

Consolidated Balance Sheet

May 31, 1981
(with comparative figures for 1980)

LIABILITIES AND SHAREHOLDERS' EQUITY

	1981	1980
CURRENT		
Accounts payable and accruals	$ 4,228,306	$ 7,378
SHAREHOLDERS' EQUITY		
Share capital (note 4)		
Authorized		
10,000,000 common shares without par value		
Issued		
4,855,282 common shares	15,551,000	140,750
	$19,779,306	148,128

Notes

May 31, 1981

1. Accounting policies.
The company, in the development stage, has established a policy of deferring all costs relating to exploration projects including related administration costs until such time as the projects are abandoned, sold or put into commercial production. The company has adopted a policy of taking depreciation on furniture and leasehold improvements on a straight line basis of 10% per year. The amounts shown for gas and oil leases and deferred costs represent costs to date and are not intended to reflect present or future values.

2. Investment in oil and gas leases.
The company has entered into agreements to participate in 37 oil and gas wells in Oklahoma, Ohio, Kansas and Texas with Texoma Resources Inc., Continental Resources Corporation and Longhorn Oil and Gas Company. Under these agreements the company has working interests ranging from 1.00% to 43.75%. As at the statement date the company has expended $12,814,198 on this program for acreage, drilling and completion costs. The company has estimated outstanding commitments for acreage, drilling, completion and miscellaneous costs of $1,157,210.

3. Gas gathering system.
Under an agreement dated July 15, 1980 with Macrim Investment Corporation, the company acquired a 25% interest in a gas gathering system in Grandview Township, Ohio. The consideration was $66,217 cash, issuance of 25,000 shares on acceptance and issue of 25,000 additional shares when Palliser Resources Inc. is returned 100% of the cash investment from revenues generated by the system. The cash portion of the consideration and the first 25,000 shares have been paid.

4. Share capital.

(a) Since corporation the company has issued stock as follows:

For cash —	2	shares @ $1.00	$ 2
	607,480	shares @ $0.10	60.748
	757,482		105,750
	100,000	shares @ $0.35 (includes $0.05 per share commission)	35,000
	162,000	shares @ $1.50 (note 4d)	243,000
	1,200,000	shares @ average of $1.858 less 7½ commission (note 4f)	2,062,537
	600,000	shares @ $3.25 less 7½% commission (note 4e)	1,803,750
	40,000	shares @ $1.85 (note 4c)	74,000
	162,000	shares @ $1.75 (note 4d)	283,500
	300,000	shares @ $3.41 (note 4e)	1,023,000
	6,650	shares @ $3.41 (note 4e)	22,676
	2,150	shares @ $3.72 (note 4e)	7,998
	1,500,000	shares @ average of $7.11 less 7½ commission	9,864,789
	4,830,282		15,526,000
For gas gathering system —			
	25,000	shares @ $1.00 (note 2)	25,000
	4,855,282		$15,551,000

(b) The company was incorporated under the Laws of British Columbia on November 21, 1978 with an authorized share capital of 10,000 common shares without par value. On December 4, 1978, by special resolution, the company increased its share capital to 10,000,000 common shares of no par value. The company remained inactive until July 1979.

(c) Under an agreement with company directors dated June 25, 1980, the company granted options on 40,000 shares. These options were exercises at $1.85 per share during March 1981.

(d) The company has entered into an agreement with D.R.M. Investments Inc. and M.R.D. Investments Inc. to issue by way of a private placement 162,000 units at $1.50. Each unit consisted of one share and one warrant. Each warrant entitled the purchaser to purchase one additional share of the company at a price of $1.75 per share for a period of up to twelve months from July 23, 1980. These warrants were exercised during the year.

(e) The company issued 600,000 units at $3.25. Each unit consists of one share of the issuer and two series "A" Share Purchase Warrants. Two warrants gives the holder the right to purchase an additional common share in the company up to April 1, 1981 at $3.41 or between April 1, 1981 to October 1, 1981 at $3.72. Up to the year end date 6,650 shares had been purchased at $3.41 and 2,150 shares were purchased at $3.72. The brokers, under the agreement, in consideration for purchasing any unsubscribed units received 300,000 Series "B" Share Purchase Warrants. The warrant permitted the brokers to purchase at $3.41 one common share for each warrant up to April 1, 1981. All warrants were exercised by the date due.

(f) The company issued shares on best efforts underwritings less 7½% commission as follows:

September 1980 — 1,200,000
May 1981 — 1,500,000

5. Consolidated Subsidiary
Palliser Resources (U.S.), Inc.

6. Subsequent to the balance sheet date the company entered into agreements to participate in 8 additional oil and gas leases with Texoma Resources Inc. The estimated commitments in respect of these leases amounts to $1,052,638.

7. The company shares management and office space with Custer Resources Inc., Tiger Oil Corp. and their subsidiaries. As a result of this relationship prospects are transacted among these companies. All these transactions are, as per agreement, offered on the same terms and basis as would be to any third party.

Auditors' Report to the Shareholders of Palliser Resources Inc.

We have examined the consolidated balance sheet of Palliser Resources Inc. as at May 31, 1981 and the consolidated statements of exploration, development and administration costs, consolidated statement of changes in financial position and notes thereto for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at May 31, 1981 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding period.

Vancouver, B.C.

Carlyle Shepherd & Co.

CARLYLE SHEPHERD & CO.
Chartered Accountants

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Palliser Resources Inc.